

**REPORT OF
FINANCIAL EXAMINATION**

**FARMERS MUTUAL INSURANCE
COMPANY OF CALLAWAY COUNTY**

**AS OF
DECEMBER 31, 2005**

**STATE OF MISSOURI
DEPARTMENT OF INSURANCE
JEFFERSON CITY, MISSOURI**

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June 22, 2006
Fulton, Missouri

Honorable W. Dale Finke, Director
Missouri Department of Insurance
301 West High Street, Room 530
Jefferson City, Missouri 65101

Sir:

In accordance with your examination warrant, a full-scope examination has been made of the records, affairs and financial condition of

FARMERS MUTUAL INSURANCE COMPANY OF CALLAWAY COUNTY

hereinafter referred to as such, or as the "Company". The Company's home office and principal place of business is located at 413 Court Street, Fulton, Missouri, telephone number (573) 642-3006. This examination began on May 23, 2006, and was concluded on May 25, 2006, and is respectfully submitted.

SCOPE OF EXAMINATION

Period Covered

The prior full-scope examination of the Company was made as of December 31, 2000, and was conducted by examiners from the State of Missouri. The current full-scope examination covers the period from January 1, 2001, through December 31, 2005, and was conducted by examiners from the Missouri Department of Insurance.

This examination also included material transactions and/or events occurring subsequent to the examination date, which are noted in this report.

Procedures

This examination was conducted using the guidelines set forth in the Financial Examiners Handbook of the National Association of Insurance Commissioners (NAIC), except where practices, procedures and applicable regulations of the Missouri Department of Insurance and statutes of the State of Missouri prevailed.

Comments-Previous Examination Report

The comments, recommendations, and notes of the previous examination report dated December 31, 2000, are listed below followed by the Company's response and the current examination findings regarding such comments, recommendations and notes.

Management and Control

Comment: The Articles of Incorporation should be amended to reflect the appropriate number of members for a quorum at member meetings.

Company Response: The Company made the necessary amendments to the Articles of Incorporation.

Current Findings: The Company amended the Articles of Incorporation quorum requirements to be in compliance with Section 380.381 RSMo (Board of directors, election--terms--vacancies--annual meeting, quorum, voting rights). However, the amended Articles of Incorporation were not properly filed with the Director of the Missouri Department of Insurance (See the Corporate Records section of this report).

Management and Control

Comment: The Company should develop a policy and procedures manual to ensure the intentions and directions of the Board of Directors are clearly communicated to all personnel.

Company Response: The Company is in the process of drafting a policy manual.

Current Findings: The Company does not have a policy manual in place (See the Management and Control section of this report).

Accounts and Records

Comment: The Board should ensure that proper approval is obtained before showing assets, with investment limits, in the annual statement.

Company Response: The Company currently requests written approval from the Missouri

Department of Insurance for all investments not allowed by statutes.

Current Findings: The assets reported by the Company during the examination comply with the statutes and regulations of Missouri.

HISTORY

General

The Company was incorporated on October 22, 1895, as Farmers Mutual Fire and Lightning Insurance Company of Callaway County. On February 16, 1980, the Company amended its Articles of Incorporation changing its name to Farmers Mutual Insurance Company of Callaway County.

The Company has a Certificate of Authority dated January 16, 1997, and is covered by Sections 380.201 through 380.611 RSMo. (Extended Missouri Mutual Companies). The Company's Certificate of Authority is renewed annually.

Management

In accordance with the Articles of Incorporation, the annual meeting of the Company's members is held on the Saturday before the third Monday in February, at the home office of the Company or at such other place as may be designated by the Board of Directors. Special meetings of the members may be called by the Board of Directors at any time and shall be called upon petition of one-fourth of the members. Eight members shall constitute a quorum at any membership meeting. Proxy voting is not permitted.

The management of the Company is vested in the Board of Directors, who are elected from the general membership. The Board of Directors consists of eight members, serving staggered, three-year terms. All directors must be policyholders of the Company. The Board of Directors meets approximately every month. Board members, with the exception of the Secretary/Treasurer and the President, receive \$150 per month and \$50 per each special meeting attended. The Company also purchases a \$20,000 life insurance policy for each board member and will pay 75% of each board member's health insurance premium if they participate in the

Company's group health plan.

Members serving on the Board of Directors as of December 31, 2005, were as follows:

<u>Name and Address</u>	<u>Occupation</u>	<u>Term</u>
Gary Crawford 3426 County Road 292 Auxvasse, Missouri	Farmer/Insurance Agent	2003-2006
Larry Smith 6970 County Road 111 Fulton, Missouri	Farmer/Insurance Agent	2004-2007
Arthur Clingman 9278 County Road 455 Mokane, Missouri	Insurance Agent / Company Manager	2003-2006
Kathy Mealy 12447 County Road 4021 Holts Summit, Missouri	Insurance Agent	2004-2007
David Guerrant 3615 State Road H Fulton, Missouri	Farmer/Insurance Agent	2003-2006
Jerry Austin 8322 County Road 134 Fulton, Missouri	Farmer/Insurance Agent	2005-2008
Gary Linnenbringer 1603 State Road M Auxvasse, Missouri	Farmer/Insurance Agent	2005-2008
Roy Rohrbach 3301 County Road 255 Fulton, Missouri	Farmer/Insurance Agent	2005-2008

The Board of Directors appoints for a term of one year, a President, a Vice-President, and a Secretary, who may also serve as Treasurer when designated by the Board. The President receives compensation of \$200 per month.

The officers of the Company serving at December 31, 2005, were as follows:

Gary Crawford

President

Larry Smith
Arthur Clingman

Vice-President
Secretary/Treasurer

Conflict of Interest

The Company has written conflict of interest procedures for the disclosure of material conflicts of interest or affiliations by its directors and officers. The Company has its directors and officers sign conflict of interest statements on an annual basis, and no material potential conflicts were disclosed.

Corporate Records

A review was made of the Articles of Incorporation and the Bylaws of the Company. On February 16, 2002, the Company amended the Articles of Incorporation to change the membership meeting minimum quorum requirements from five to eight members. In addition, all references to "assessments" in the Articles of Incorporation were changed to "premiums," to facilitate the Company's conversion to a non-assessable company. On February 11, 2002, the Company also amended the Bylaws to change all references from "assessments" to "premium". The Company failed to file the amended Articles of Incorporation and Bylaws with the Director of the Missouri Department of Insurance in accordance with Section 380.241 RSMo (Amendment to Articles and Bylaws, Procedure-Fee). The Company is directed to file its amended Articles of Incorporation and Bylaws in accordance with the statute.

The minutes of the membership and the Board of Directors' meetings were reviewed for the period under examination. The minutes and records of the Company appear to properly reflect corporate transactions and events. The Company does not have a written policy and procedures manual. It is recommended the Company draft and approve a written policy and procedures manual, which should be made available to all Company officials and employees.

FIDELITY BOND AND OTHER INSURANCE

The Company is a named insured on a fidelity bond providing a limit of liability of \$75,000. The

fidelity bond coverage of the Company does not meet the minimum amount suggested in the guidelines promulgated by the NAIC, which is between \$100,000 and \$125,000 in coverage. It is recommended the Company increase its fidelity bond coverage to a minimum limit of \$100,000.

The Company carries liability coverage for its directors and officers with an aggregate limit of \$2,000,000 and a \$1,000 deductible in aggregate for each claim.

The Company carries errors and omissions liability coverage for its agents with an aggregate limit of \$1,000,000 and a \$1,000 deductible for each claim.

The Company also carries property insurance coverage on its home office and equipment, as well as business liability insurance.

The insurance coverage appears adequate.

EMPLOYEE BENEFITS

The Company has three full-time employees and one part-time employee. The Company provides health and life insurance benefits to full-time employees and contributes 6% of each full-time employee's gross salary into individual retirement accounts. Each year, full time employees receive ten paid sick days plus an additional thirty sick days at one-half pay if needed, as well as two to four weeks of paid vacation, depending upon years of service. The Company appears to have made adequate provisions in the financial statements for these employee benefits.

INSURANCE PRODUCTS AND RELATED PRACTICES

Territory and Plan of Operation

The Company is licensed by the Missouri Department of Insurance as an Extended Missouri Mutual Company operating under Sections 380.201 through 380.611 RSMo. (Extended Missouri Mutual Companies). The Company is authorized to write fire, wind and liability insurance in all counties in the State of Missouri.

The Company writes fire, wind and liability coverages. The Company's policies are sold by eight licensed producers, who are also directors of the Company. The producers receive a 15% commission.

Policy Forms and Underwriting Practices

The Company uses AAIS policy forms. The policies are written on a continuous period. Rates are determined by the Board of Directors. Renewal billings are mailed directly to the insured. Inspections and adjusting services are performed by the director/producers.

GROWTH AND LOSS EXPERIENCE OF THE COMPANY

	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Gross Assessment</u>	<u>Gross Losses</u>	<u>Investment Income</u>	<u>Underwriting Income</u>	<u>Net Income</u>
2005	\$6,193,505	\$903,605	\$2,011,856	\$1,049,112	\$289,292	\$23,098	\$297,092
2004	7,152,994	957,809	1,928,454	806,981	277,956	193,782	396,512
2003	6,656,023	857,348	1,752,799	737,691	276,134	199,477	391,416
2002	6,290,848	883,590	1,558,792	1,948,394	277,865	(106,901)	193,007
2001	6,263,212	1,048,961	1,509,537	1,376,364	297,745	66,693	330,578

At year-end 2005, 4,803 policies were in force.

REINSURANCE

General

The Company's reinsurance premium activity on a direct-written, assumed and ceded basis for the period under examination is shown below:

	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
Direct	\$1,481,676	\$1,558,792	\$1,752,799	\$1,928,454	\$2,011,856
Assumed	0	0	0	0	0
Ceded	<u>(252,383)</u>	<u>(255,022)</u>	<u>(293,844)</u>	<u>(345,084)</u>	<u>(408,809)</u>
Net	<u>\$1,229,293</u>	<u>\$1,303,770</u>	<u>\$1,458,955</u>	<u>\$1,583,370</u>	<u>\$1,603,047</u>

Assumed

The Company participates in a reinsurance pool with MAMIC Mutual Insurance Company (MMIC). The agreement pertains to errors and omissions policies and director and officer liability policies written by MMIC. MMIC cedes 100% of the first \$1,000,000 each claim and in aggregate on all insurance agent and broker errors and omissions policies and 100% of the first \$2,000,000 each claim and in aggregate on all officer and director liability policies to the pool. MMIC receives a 35% ceding commission of net written premium ceded to the pool. The Company has a 1% share in the interests and liabilities of the pool.

Ceded

The Company has all of its reinsurance through Grinnell Mutual Reinsurance Company (the reinsurer) under a single reinsurance contract for fire, wind and liability risks. The aggregate excess section of the agreement covers fire and wind risks. The Company's annual aggregate net retention, or attachment point, is based upon the Company's ten-year average fire loss ratio plus a load, which is mutually agreed upon. The reinsurer is liable for 100% of losses in excess of this retention. The attachment point for 2005 was \$1,284,027 and the annual premium paid was \$.4029 per \$1,000 of adjusted gross fire risks in force. Property risks ceded under the agreement are limited to \$500,000 for dwellings, commercial and public property, and livestock, poultry and horse operations, and limited to \$750,000 for farm outbuildings. Risks in excess of these limits may be ceded to the reinsurer on a facultative basis per the agreement provisions. Rates and acceptability of risks ceded under the facultative provisions are determined by the reinsurer on an individual basis.

The agreement also provides for liability risk coverage. The Company cedes 100% of the risk and premium to the reinsurer and receives a 20% ceding commission.

The Company is contingently liable for all reinsurance losses ceded to others. This contingent liability would become an actual liability in the event that any assuming reinsurer should fail to perform its obligations

under its reinsurance agreement with the Company.

ACCOUNTS AND RECORDS

The accounting records are maintained by the Company on a modified cash basis. David J. Shively, CPA performs financial statement compilation and Annual Statement and tax preparation services for the Company.

FINANCIAL STATEMENTS

The following financial statements, with supporting exhibits, present the financial condition of the Company for the period ending December 31, 2005, and the results of operations for the year then ended. Any examination adjustments to the amounts reported in the Annual Statement and/or comments regarding such are made in the "Notes to the Financial Statements," which follow the Financial Statements. (The failure of any column of numbers to add to its respective total is due to rounding or truncation.)

There may have been differences found in the course of this examination, which are not shown in the "Notes to the Financial Statements." These differences were determined to be immaterial, concerning their effect on the financial statements. Therefore, they were communicated to the Company and noted in the workpapers for each individual annual statement item.

ANALYSIS OF ASSETS
December 31, 2005

Bonds	\$ 6,193,505
Stocks	103,273
Real Estate	52,151
Cash on Deposit	952,283
Other Investments	10,980
Federal Income Tax Recoverable	2,439
Interest Due and Accrued	81,251

Total Assets	<u><u>\$ 7,395,882</u></u>

LIABILITIES, SURPLUS AND OTHER FUNDS
December 31, 2005

Losses Unpaid	\$ 83,117
Ceded Reinsurance Payable	32,356
Unearned Premium	787,261
Liability Write-Ins	\$ 871

Total Liabilities	\$ 903,605

Guaranty Fund (Note 1)	\$ 150,000
Other Surplus (Note 1)	6,342,277

Total Surplus	\$ 6,492,277

Total Liabilities and Surplus	<u><u>\$ 7,395,882</u></u>

STATEMENT OF INCOME
December 31, 2005

Net Premium	\$ 1,618,187
Other Insurance Income	27,663
Net Losses Incurred	(1,047,198)
Other Underwriting Expenses	(575,554)

Net Underwriting Income (Loss)	\$ 23,098

Investment Income	\$ 289,292
Other Income	7,104

Gross Income (Loss)	\$ 319,494
Federal Income Tax	(22,402)

Net Income (Loss)	\$ 297,092
	=====

CAPITAL AND SURPLUS ACCOUNT
December 31, 2005

Policyholders' Surplus, December 31, 2004	\$ 6,195,186
Net Income (Loss)	297,092

Policyholders' Surplus, December 31, 2005	\$ 6,492,278
	=====

NOTES TO THE FINANCIAL STATEMENTS

Note 1 – Guaranty Fund and Other Surplus

The Company's guaranty fund balance of \$945,478 exceeded the calculated amount per the requirements of Section 381.271 RSMo (Financial Reinsurance Requirements) by \$795,478. The minimum guaranty fund balance of \$150,000 is sufficient based on the Company's net wind and fire insurance in-force at December 31, 2005 and net liability premium in 2005. This examination change decreased the guaranty fund balance and increased the other surplus balance by \$945,478.

EXAMINATION CHANGES

Total Policyholder's Surplus Per Company, December 31, 2005			\$ 6,492,278
	Increase in Surplus	Decrease in Surplus	
Guaranty Fund	\$ 0	\$ (795,478)	
Other Surplus	\$ 795,478	\$ 0	
	-----	-----	
Total Change	<u>\$ 795,478</u>	<u>\$ (795,478)</u>	<u>0</u>
Total Policyholder's Surplus Per Examination, December 31, 2005			<u>\$ 6,492,278</u>

GENERAL COMMENTS AND RECOMMENDATIONS

Corporate Records (Page 5)

The Company is directed to file its amended Articles of Incorporation and Bylaws in accordance with Section 380.241 RSMo (Amendment to Articles and Bylaws, procedure-fee).

The Company does not have a written policy and procedures manual. It is recommended the Company draft and approve a written policy and procedures manual, which should be made available to all Company officials and employees.

Fidelity Bond and Other Insurance (Page 6)

It is recommended the Company increase its fidelity bond coverage to a minimum limit of \$100,000.

SUBSEQUENT EVENTS

None.

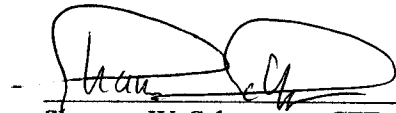
ACKNOWLEDGMENT

The assistance and cooperation extended by the employees of Farmers Mutual Insurance Company of Callaway County during the course of this examination is hereby acknowledged and appreciated.

VERIFICATION

State of Missouri)
) ss
County of Cole)

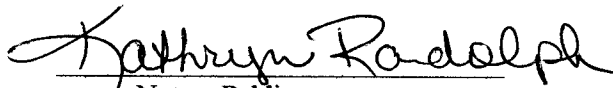
I, Shannon W. Schmoeger on my oath swear that to the best of my knowledge and belief the above examination report is true and accurate and is comprised of only the facts appearing upon the books, records or other documents of the company, its agents or other persons examined or as ascertained from the testimony of its officers or agents or other persons examined concerning its affairs and such conclusions and recommendations as the examiners find reasonably warranted from the facts.

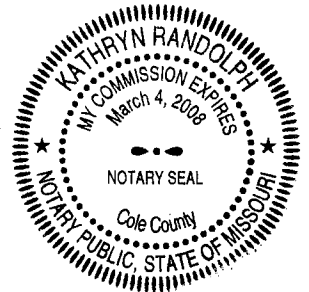

Shannon W. Schmoeger, CFE
Financial Examiner
Missouri Department of Insurance

Sworn to and subscribed before me this 22nd day of June, 2006.

My commission expires:


March 4, 2008


Kathryn Randolph
Notary Public



SUPERVISION

The examination process has been monitored and supervised by the undersigned. The examination report and supporting workpapers have been reviewed and approved. Compliance with NAIC procedures and guidelines as contained in the Financial Condition Examiners Handbook has been confirmed.


Frederick G. Heese, CFE, CPA
Audit Manager – Kansas City
Missouri Department of Insurance

Farmers' Mutual Insurance Co. of Callaway County

Gary Crawford, President
Arthur Clingman, Secretary
P.O.Box 316
Fulton, MO 65251

(573) 642-3006
FAX (573) 642-3047
1-877-642-3006

August 27, 2006

Kirk Schmidt, CFE, CPA
Chief Financial Examiner
Department of Insurance
P.O. Box 690
Jefferson City, Missouri 65102-0690

Dear Mr. Schmidt,

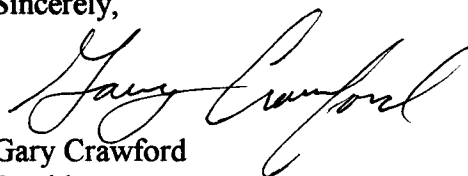
The Company is working on filing the amended Articles of Incorporation and Bylaws in accordance with Section 380.241 RSMo.

The Company is in the process of developing a written policy and procedures manual.

The Fidelity bond has been increased to \$100,000.

This response may be included in the report as a public document.

Sincerely,


Gary Crawford
President

RECEIVED
AUG 30 2006
INSURANCE SOLVENCY
&
COMPANY REGULATION